

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **200837004**

Release Date: 9/12/2008

Index Number: 103.02-01, 115.00-00, 115.03-00

Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:FIP:BR5
PLR-104981-08
Date:
May 22, 2008

LEGEND:

Authority =

State =

City =

Act =

Federal Agency =

Corporation =

Year =

Dear :

This responds to your request for rulings, submitted by your authorized representatives on behalf of Authority, that (1) Authority qualifies as a political subdivision of State for purposes of section 103 of the Internal Revenue Code ("Code"), and (2) Corporation is

an entity engaged in an essential governmental function and that, as such an entity, any income realized by Corporation is excludable from gross income under section 115(1).

Facts and Representations

You make the following factual representations. Authority is a public body, corporate and politic, organized and existing under Act of State. The City Council of City created Authority in Year for the general purposes of clearing, re-planning, and reconstructing areas of City in which unsanitary or unsafe housing existed. In addition to the general purposes above, Authority provides safe and sanitary dwelling accommodations for City's low-income residents. More specifically, Authority provides the largest supply of low-income housing in City. Authority has been actively involved in providing publicly-owned and operated housing since Year. Authority derives its revenues from rents paid by the tenants of its housing units and from rent subsidies and other payments provided from Federal Agency.

Authority is governed by a seven-member Board of Commissioners ("Board"). Each member of Board is appointed by City's mayor, subject to City Council's confirmation. Of the seven Board members, two are required to be tenants from Authority's housing developments. These two Board members serve two year terms, while the other five members appointed to Authority's Board serve four year terms. There is no limit on the number of terms that a Board member may serve. The City Council, however, may remove a Board member for inefficiency, neglect of duty, or misconduct in office. Authority's daily operations are conducted under the direction of its Executive Director. The Board, which is responsible for Authority's policy and fiscal management, appoints the Executive Director.

Authority is required to have all of its funds audited at least once a year. All audits, together with a final balance sheet, operation statement, and budget must be filed with Federal Agency. Authority is also required, at least once a year, to provide City with a report of its activities for the prior year.

The State legislature has delegated to Authority the power, acting through the members of the Board or other person or persons designated by Authority, to acquire by eminent domain any real property that Authority deems necessary for its purposes after the adoption by Authority of a resolution declaring that the acquisition of the real property described in the resolution is necessary for Authority's purposes. Property already devoted to a public use may be acquired by Authority through eminent domain, but real property belonging to City or State may not be acquired by Authority without their consent.

Authority created Corporation, a nonprofit public benefit corporation, pursuant to the general nonprofit corporation law of State. Pursuant to Corporation's Articles of Incorporation ("Articles"), the Corporation is managed by a Board of Directors

(“Directors”) consisting of three to five members at any one time. Each Director appointed to Corporation’s Board must also be a Board member in good standing on Authority’s Board. A Director can serve on Corporation’s Board so long as they remain in good standing as a member of Authority’s Board. Upon ceasing to be a member of good standing on Authority’s Board, such a person automatically ceases to be a Director of Corporation.

According to the Articles, Corporation is generally organized to own and operate multi-family residential rental and related facilities, land, and equipment for the exclusive use and benefit of Authority. In order to carry out the aforementioned general purpose, the Corporation’s Articles also state that the Corporation may: 1) acquire, purchase, own, construct, lease, hold, sell, assign, pledge, manage, and otherwise deal with real and personal property; and 2) borrow the necessary funds to pay the cost of financing, refinancing, acquiring, constructing, replacing, establishing, improving, maintaining, equipping, and operating such real and personal property.

During the continuance of its operations, the Articles empower Corporation to distribute any of its assets to Authority. If, for any reason, Authority declines to accept any such assets, then the assets can only be distributed to State, a political subdivision of State, or an entity exempt from federal income tax under section 115. Corporation’s Articles provide for identical treatment of Corporation’s assets in the event of Corporation’s dissolution. However, the Articles generally prohibit Corporation’s income and earnings from inuring to any private person, corporate or individual, or to any other private interest.

Law and Analysis

Political Subdivision

The Code does not define the term “political subdivision.” Section 1.103-1(b) of the Income Tax Regulations provides that the term “political subdivision” denotes any division of any state or local governmental unit that is a municipal corporation or that has been delegated the right to exercise part of the sovereign power of the unit. As thus defined, a political subdivision of any state or local governmental unit may or may not, for purposes of this section, include special assessment districts so created, such as road, water, sewer, gas, light, reclamation, drainage, irrigation, levee, school, harbor, port improvement, and similar districts and divisions of these units.

Three generally acknowledged sovereign powers of states are the power to tax, the power of eminent domain, and the police power. Commissioner v. Estate of Alexander V. Shamberg, 3 T.C. 131 (1944), acq., 1945 C.B. 6, aff’d, 144 F.2d 998 (2d Cir. 1944), cert denied, 323 U.S. 792 (1945). It is not necessary that all three of these powers be delegated in order to treat an entity as a political subdivision for purposes of the Code. However, possession of only an insubstantial amount of any or all of the sovereign

powers is not sufficient. All of the facts and circumstances must be taken into consideration, including the public purposes of the entity and its control by a government. Rev. Rul. 77-164, 1977-1 C.B. 20.

Consideration of these principles as they apply to the facts of this case leads us to conclude that Authority is a political subdivision of State for purposes of § 1.103-1(b). Authority was created pursuant to State legislation and is organized under State law. Each of the Board's seven Commissioners is appointed by the Mayor of City. Authority is required to have all of its funds audited at least once a year, and it is also required, at least once a year, to provide City with a report of its activities for the prior year.

The State legislature has delegated to Authority the power, acting through the Commissioners or other person or persons designated by Authority, to acquire by eminent domain any real property that Authority deems necessary for its purposes after the adoption by Authority of a resolution declaring that the acquisition of the real property described in the resolution is necessary for Authority's purposes. Property already devoted to a public use may be acquired by Authority through eminent domain, but real property belonging to City or State may not be acquired by Authority without their consent.

Authority's purpose of clearing, re-planning, and reconstructing areas in City where unsanitary or unsafe housing conditions exist, and providing safe and sanitary dwelling accommodations for persons of low income throughout City, is a wholly public purpose.

Under State law, Authority is granted powers of eminent domain to carry out authorized purposes. Other than certain procedural safeguards, Authority may initiate eminent domain actions in its own name without limitation.

Section 115(1) – Essential Governmental Function

Section 115(1) of the Code provides that gross income does not include income derived from any public utility or the exercise of any essential governmental function and accruing to a state or any political subdivision of a state.

Under Rev. Rul. 77-261, 1977-2 C.B. 45, the income from an investment fund, established under a written declaration of trust by a state for the temporary investment of cash balances of the state and its political subdivisions, was excludable from gross income for federal income tax purposes under section 115(1). The ruling indicated that the statutory exclusion was intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of a corporation or other entity engaged in the operation of a public utilities or in the performance of some governmental function that accrued to either a state or municipality. The ruling points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying

out projects that are desirable from the standpoint of a state government and that are within the ambit of a sovereign properly to conduct. In addition, pursuant to section 6012(a)(2) and the underlying regulations, the investment fund, being classified as a corporation that is subject to taxation under subtitle A of the Code, was required to file a federal income tax return each year.

In Rev. Rul. 90-74, 1990-2 C.B. 34, the Service determined that the income of an organization formed, funded, and operated by political subdivisions to pool various risks (casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under section 115 of the Code. In Rev. Rul. 90-74, private interests neither materially participate in the organization nor benefit more than incidentally from the organization.

Corporation is organized to own and operate multi-family residential rental and related facilities, land, and equipment for the exclusive use and benefit of Authority. These functions carry out many of the functions of providing low-income housing to residents of City that Authority itself provides. Providing, maintaining, and operating low-income housing units has been recognized as an essential government function. Thus, Corporation provides an essential government function.

Corporation's income and the assets accrue to the benefit of Authority, a political subdivision of State. Corporation's Articles ensure that no part of Corporation's income and earnings shall inure to the benefit or profit of any private interest. Additionally, Corporation's Articles restrict that any current distributions of corporate assets be made to Authority, State, any political subdivision of State, or any entity exempt from federal income tax under section 115. The Articles also mandate such distribution treatment in the event of Corporation's dissolution. Therefore, the Articles sufficiently provide that Corporation's gross income accrues to a state or political subdivision for purposes of section 115.

Based on the information and representations submitted, we hold that the Corporation's income is derived from the exercise of an essential governmental function and will accrue to a state or a political subdivision thereof for the purposes of section 115(1). Accordingly, Trust's income is excludable from gross income under section 115(1) of the Code.

Conclusion

Based on the information submitted and representations made, we conclude that (1) Authority is a political subdivision of State for purposes of section 103 because Authority has been delegated the right to exercise sovereign power, is controlled by State, and is motivated by a wholly public purpose; and (2) Corporation's income is excludable from gross income under section 115(1) because Corporation's income is derived from the

exercise of an essential governmental function and will accrue to a state or a political subdivision thereof for the purposes of section 115(1).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with a Power of Attorney on file with this office, a copy of this letter is being sent to Authority's authorized representative.

The ruling contained in this letter is based upon information and representations submitted by Authority and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the materials submitted in support of the request for a ruling, it is subject to verification upon examination.

Sincerely,

Associate Chief Counsel
(Financial Institutions and Products)

By: _____
James A. Polfer
Chief
Branch 5

cc: